

# INSTRUCTIONS FOR FORM N-332 RESIDENTIAL CONSTRUCTION AND REMODELING TAX CREDIT

## GENERAL INSTRUCTIONS

**Caution:** The credit is applicable to costs incurred **before July 1, 2003**; the credit cannot be claimed for costs incurred after that date.

Section 235-110.45, Hawaii Revised Statutes (HRS), as amended by Act 174, Session Laws of Hawaii 2002, provides that each owner, developer or lessee of residential real property subject to Hawaii's net income tax may claim a residential construction and remodeling tax credit of 4 percent of the qualified construction or remodeling costs (not exceeding \$250,000 in the aggregate) incurred during the taxable year for which the credit is claimed for each residential unit located in Hawaii.

No tax credit shall be allowed for that portion of the construction or remodeling costs for which another tax credit was claimed under Hawaii's net income tax law for the taxable year.

If a deduction is taken under Internal Revenue Code (IRC) section 179 (regarding an election to expense certain depreciable business assets) no tax credit shall be allowed for that portion of the construction or remodeling costs for which the deduction was taken.

The basis of eligible property for depreciation or ACRS purposes for state income taxes shall be reduced by the amount of tax credit allowable and claimed. Alternatively, you may treat the amount of the credit allowable and claimed as a taxable income item for the taxable year in which it is properly recognized under the method of accounting used to compute taxable income.

The tax credit shall be available for taxable years beginning after December 31, 2000, and shall not be available for taxable years beginning after December 31, 2003 for costs incurred before July 1, 2003.

In the case of a partnership, S corporation, estate, trust, or association of apartment owners, the tax credit allowable is for qualified construction or remodeling costs incurred by the entity for the taxable year. The construction or remodeling costs upon which the tax credit is computed is determined at the entity level. Each partner, S corporation shareholder, or beneficiary of an estate or trust shall separately take into account for its taxable year with or within which the entity's taxable year ends, the partner's, shareholder's, or beneficiary's share of the construction or remodeling costs and resulting tax credit. A partner's

share of the construction or remodeling costs shall be determined in accordance with the ratio in which the partners divide the general profits of the partnership. The construction or remodeling costs of the partnership which are subject to a special allocation that is recognized under IRC section 704(a) and (b) shall be recognized for the purposes of this tax credit. Each S corporation shareholder's construction or remodeling costs is the shareholder's allocated share of the S corporation's construction or remodeling costs. A beneficiary's share of the construction or remodeling costs is allocated between the entity and the beneficiaries based on the income of the entity allocable to each. The term "beneficiary" includes an heir, legatee, or devisee. Associations of apartment owners see the instructions for Part II.

**Tax credit to be deducted from income tax liability.** Tax credits which exceed the taxpayer's net income tax liability may be used as credit against the taxpayer's net income tax liability in subsequent years until exhausted.

**Time for filing.** All claims for the tax credit must be filed on or before the end of the 12th month following the close of the taxable year for which the tax credit may be claimed. An extension of time for filing a return does not extend the time for claiming the tax credit. Failure to comply with the foregoing provision shall constitute a waiver of the right to claim the tax credit.

**When credit can be claimed.** The credit may be claimed for the taxable year in which the costs were incurred. When costs are incurred depends on a taxpayer's method of accounting. For cash basis taxpayers, costs are incurred when paid; therefore, costs paid on or after July 1, 2003 are not eligible for the tax credit. For accrual basis taxpayers, costs are incurred when the expense is recognized.

**Definitions.** For purposes of the tax credit:

"Construction or remodeling cost" means any cost incurred after December 31, 2000 (and before July 1, 2003), for plans, design, construction, and equipment related to new construction, alterations, or modifications to a "residential apartment unit or house."

"Residential apartment unit or house" means a house or apartment used to provide living accommodations in a building or

structure. Costs incurred to construct or remodel any structure not constituting a living accommodation (i.e., living area) or not an integral part of the living accommodation will not be eligible for the tax credit.

There is a lifetime "cap" of \$250,000 in costs incurred for each residential unit. For purposes of applying this cap, each house and each apartment unit will be treated as a single "residential unit."

The plain meaning of the terms "alter" and "modify" require actions which change a property by renewing its condition. Maintenance is the act of making repairs to prevent a decline or lapse in the existing state or condition. Routine maintenance or repairs would not qualify for the credit because routine maintenance or repairs do not change a property by renewing its condition. To the extent that incidental maintenance or repairs are incurred as part of a general plan of renovation, however, these expenses will qualify for the credit since they are incurred as part of an expenditure to improve a property. Examples of improvements which would qualify for the credit include the addition of a new room, putting in new plumbing or wiring, putting on a new roof, or installing new carpet. Examples of things which would **not** qualify include repainting the inside of your house, fixing your gutters or floors, replacing broken windows, patching or repairing floors, or replacement of small parts.

The plain meaning of the term "incurred" means "to become liable or subject to". The taxpayer's method of accounting will determine when costs were "incurred". Example 1: Taxpayer uses the cash method of accounting. Taxpayer signs a contract in May 2003 to remodel a residential unit. Taxpayer pays for these costs beginning in July 2003. These costs are not eligible for the Credit. Example 2: Taxpayer uses the cash method of accounting. Taxpayer pays construction or remodeling costs for a residential unit, which is not completed before July 1, 2003. The costs paid before July 1, 2003 may be eligible for the Credit; costs paid on or after July 1, 2003 are not eligible for the Credit. Example 3: Assume the same facts as in Example 2, except that Taxpayer uses the accrual method of accounting. Costs incurred before July 1, 2003, may be eligible for the Credit depending on when Taxpayer recognizes the costs in its books and records.

See Tax Information Release No. 2002-3 for additional information.

## SPECIFIC INSTRUCTIONS

### Part I

**Line 1** — Enter the qualifying construction or remodeling costs incurred before July 1, 2003 for a residential unit located in Hawaii. Do not include that portion of the construction or remodeling costs for which another tax credit was claimed under chapter 235, HRS, for the taxable year. Do not include that portion of the remodeling cost for which a deduction is taken under IRC section 179. Do not include costs for routine maintenance or repairs. Costs are limited to \$250,000 per unit in the aggregate. This means that if two people own a house and they jointly incur \$300,000 in remodeling costs during 2001, only a total of \$250,000 of the costs may be claimed for the credit by the two people. If these same two people incur \$25,000 in additional remodeling costs for the same house in January, 2002, none of this amount may be claimed for the credit as total costs per unit are limited to \$250,000.

**Line 2** — Flow through of qualifying residential construction or remodeling costs received from other entities, if any. In the case of a taxpayer who is a member of a pass-through entity (i.e., partnership, S corporation, estate, or trust) and who claims a tax credit for the entity's qualified construction or remodeling costs, enter the amount of the costs received from the entity on line 2.

**Line 3** — Estates and trusts: The total cost on line 3 is to be allocated between the estate or trust and the beneficiaries in the proportion of the income allocable to each party. On the dotted line to the left of line 3, enter the cost allocable to the estate or trust with the designation "N-40 PORTION". Attach Form N-332 to the N-40 return.

Form N-20 and N-35 filers, stop here. Form N-20 filers, enter the amount on line 3 on Schedule K, line 27. Form N-35 filers, enter the amount on line 3 on Schedule K, line 12o. Form N-40 filers enter the distributive share amount on line 10 of Schedule K-1, Form N-40, for each beneficiary, otherwise continue to line 4. All others, continue to line 4.

**Line 6** — This line is for the carryover of unused residential construction and remodeling tax credit.

**Line 7** — Add lines 5 and 6. This is your tentative current year residential construction and remodeling tax credit.

### Tax Liability Limitations

The tax credit shall be claimed against the net income tax liability for the taxable year in which the tax credit is properly claimed. "Net income tax liability" means income tax liability reduced by all other credits allowed under chapter 235, HRS.

**NOTE:** If you are also claiming the Low-Income Housing Tax Credit (Form N-586), complete Form N-586 before completing this form. If you have any carryover of unused credit from Form N-586, do not complete lines 8 and 9 of this form. Enter zero on line 10 and continue to line 12. Your total residential construction and remodeling tax credit cannot be used this year and must be carried over to next year.

If you are also claiming the High Technology Business Investment Tax Credit (Form N-318), complete Form N-318 before completing this form. If you have any carryover of unused credit from Form N-318, do not complete lines 8 and 9 of this form. Enter zero on line 10 and continue to line 12. Your total residential construction and remodeling tax credit cannot be used this year and must be carried over to next year.

If you are also claiming the Technology Infrastructure Renovation Tax Credit (Form N-326), complete Form N-326 before completing this form. If you have any carryover of unused credit from Form N-326, do not complete lines 8 and 9 of this form. Enter zero on line 10 and continue to line 12. Your total residential construction and remodeling tax credit cannot be used this year and must be carried over to next year.

**Line 8** — Enter the tax liability before any credits from the appropriate line of your tax return.

**Line 9** — The law requires that ALL other credits offset a taxpayer's tax liability BEFORE allowing a residential construction and remodeling tax credit. Complete the **Credit Offset Worksheet** on the back of Form N-332 and enter the result on line 9.

**Line 11** — Compare the amounts on lines 7 and 10. Enter the smaller of line 7 or 10 here. This is your maximum credit allowed for this taxable year.

### Part II

Part II is for associations of apartment owners and associations of interval apartment owners (AIAO) to provide information to the associations' owner-members regarding the members' share of the associations' qualifying construction or remodeling costs. Each member must qualify for the credit on its own. The fact that this information is provided to a member does not qualify that member to claim the credit.

Any association of apartment owners or AIAO which has incurred qualifying construction or remodeling costs for residential real property located in Hawaii shall provide to its members a statement of the member's share of those qualifying costs on this form.

Costs are limited to \$250,000, in the aggregate, for each unit.

**Name of association** — The association's name is to appear in the name space near the top of the form.

**Line 1.** — Member's name. Enter the member's name on this line.

**Line 2.** — Member's identification number. Enter the member's social security number or federal employer identification number.

**Line 3.** — Member's share of qualifying costs. Enter the member's share of the total qualifying construction or remodeling costs incurred by the association.

### Instructions for Members

If you have received this form from your association, see the General Instructions of this form to determine if you qualify to take this credit. If you qualify to take the credit, enter the amount in Part II, line 3 of the Form N-332 you received from your association of apartment owners or AIAO on line 2 of Part I and check box d of the Form N-332 you will use to compute your credit and file with your return.